DANNON™

Testimony of
The Dannon Company, Inc.
100 Hillside Ave.
White Plains, NY 10591

In the Matter of the
National Public Hearing
For Federal Milk Marketing Orders
Under Docket No: AO-14-A73, et al.
DA-03-10

June 20, 2005
Sheraton Station Square Hotel
300 West Station Square Drive
Pittsburgh, PA 15219

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The Dannon Company, Inc. (Dannon) expresses appreciation to the Secretary for the opportunity to appear and support our proposal to amend the Fluid Milk Product (FMP) definition under the federal milk marketing orders. Within the body of our testimony we will oppose other specific proposals submitted for consideration at this hearing.

1 The Dannon Company, Inc.

1.1 General information :

Dannon is a wholly owned subsidiary of The Danone Group "(the Group)" headquartered in Paris, France. Group Danone is a publicly traded company, trading under the symbol DA and is listed on the New York Stock Exchange. The Group's sales in 2004 were in excess of $17 billion. Employees of Group Danone are in excess of 89,000. Globally, the three primary areas in which we function are fresh dairy products, water and cookies. There are other areas in which we operate, but these are the most significant. We produce yogurt and fresh dairy products in 40 countries around the world.

1.2 Manufacturing plants :

Dannon is part of the North American zone of dairy operations for the Group. In the US, Dannon operates three yogurt manufacturing locations: Minster, OH; Ft. Worth, TX; and West Jordan, UT. We have a co-packing relationship with one processor for some of our production. The North American corporate headquarters for the Group is located at 100 Hillside Avenue, White Plains, NY 10603.

1.3 The Dannon Company's raw milk supply:

The supply of raw milk for our yogurt production in our Ohio, Texas and Utah locations comes through a dairy cooperative. Dannon has no independent dairy farmers from whom it purchases milk directly. To our knowledge, with the exception of perhaps a couple of times during the last eight years, the milk we receive from the supplying cooperative is pooled milk. For the calendar year 2004, Dannon purchased in excess of 675 million pounds of milk for use in making yogurt products. Dannon is a major producer of regular yogurt and yogurt containing beverages sold in the US market and, as such, has a significant interest in these proceedings.

The Dannon Company pays the announced federal milk order price for raw milk purchased from our supplying cooperative and the announced premium for the classes of milk for the area in which each one of our plants is located. Milk is our most important raw material and milk cost is the major component of our raw material cost. Changes in the milk cost come through market evolution, the premiums we pay our milk supplier and the classification of the products once produced. Evolution of these cost drivers will affect very significantly our cost of doing business.

2 Yogurt containing beverages are class II under the California State Order:

As outlined in the California Dairy Statistics Annual 2004 page 49, yogurt containing beverages produced and sold within California, are classified as class II. We request Official Notice be taken of California Dairy Statistics Annual 2004.

Those products enjoy the benefit of a lower price whereas products manufactured outside of the State of California would compete in the California market priced at class I.

This results in inequitable treatment of yogurt containing beverage processors, particularly when there are those of us who manufacture such products in a federally regulated area and market the products in the state of California.

3 Reaction to other submitted proposals

3.1 Proposal 1 DFA:

We are opposed to the adoption of Proposal 1 as listed in the Notice of Hearing. All beverages containing some milk or milk derivatives are not in competition with fluid milk as we will prove for yogurt and yogurt containing drinks in the body of our direct testimony. To us, it just doesn't seem within the realm of possibility that all products containing any milk or milk solids can be deemed to be competing with fluid milk. Consumers have a variety of reasons for consuming beverages, such as smoothies. All drinkable beverages, including yogurt, do not compete with sales of fluid milk.

3.2 Proposal 2 DFA:

Dannon is also opposed to including whey when calculating the milk solids not fat contents of the product. That was not the original intent of the definition when it was adopted.

We usually think of whey as the product of some type of cheese making. There are solids in whey that have uses in other products for texture or other functions. The fact that a processor may use whey in making a food product should not have an impact on whether the product meets the Fluid Milk Product definition. The volume of solids has been priced once and a secondary use of a by-product should not count in making a product meet the definition of FMP.

3.3 Proposal 3 O-At-Ka:

Dannon is opposed to Proposal 3 because we are not in favor of the federal milk marketing program moving to a protein specific threshold in the definition of Fluid Milk Products. We will address the opposition to protein threshold in section 2.11. Moving to a specific protein content for the Fluid Milk Product definition does nothing to help determine whether a product is really competing with fluid milk beverages.

3.4 Proposal 4 Select Milk Producers:

Dannon has no position on this proposal.

3.5 Proposal 5 HP Hood LLC:

Dannon has no position on this proposal.

3.6 Proposal 6 HP Hood LLC:

Dannon has no position on this proposal.

3.7 Proposal 7 National Milk Producers:

Dannon is opposed to Proposal 7 for the same reason given above and as covered later in section 2.11.

3.8 Proposal 9 General Mills:

Dannon's opposition to this proposal comes only with respect to the content of a protein threshold in the Fluid Milk Product definition. With respect to the yogurt content of the product, we support the proposed 20% minimum level offered by General Mills.

3.9 Proposal 10 Novartis:

Dannon is opposed to Proposal 10 because it would remove the 6.5% milk solids not fat from the definition.

3.10 Proposal 11 Hormel Foods:

Dannon has no comment on Proposal 11.

3.11 General comment for protein threshold:

We oppose the adoption of a protein specific level in the definition of Fluid Milk Product. The FMP definition states 6.5% milk solids not fat as the threshold for determining a product's classification. There is no mention of protein or the relationship protein has to the defined MSNF content. It was assumed to be the regular relationship of 2.24%, but what if it weren't? That case is not addressed in the definition and, since there is no protein level specifically addressed, we do not believe one can be assumed. The only measurable threshold the industry has is that of MSNF at 6.5%.

3.11.1 No merits of protein threshold for the product:

Movement to a specific protein level for determining a product that meets the definition of FMP does not solve the classification problem for the department. Under a protein threshold scenario, more products will most likely meet the FMP definition and thereby be classified as Class I when they are not necessarily competing with fluid milk sales. The Act specifically includes the defining "form and use" challenge, and does not specifically include a MSNF or Protein challenge. The MSNF criterion was included by the Department in an attempt to provide an easy measure for "form and use".

Under a protein specific level and current Class I pricing rules, processors producing Class I products would still be charged on the skim equivalent and butterfat used in those products that are Class I, not necessarily on the protein used in the production of those products. There will be some standard set for determining the skim equivalent of the protein used by source. That skim equivalent will then be used as the invoicing volume. In other words, Class I would be charged based on protein utilization while protein, in general, has

never been a key driver for products in the fluid milk classification. Protein should not serve that function for determining Class I products. We do not see merits for such a rule from a product standpoint.

3.11.2 Consequences of protein threshold on use of dairy protein:

Use of a protein specific level for a threshold to determine the first hurdle in classification is unnecessary and burdensome to the industry. We believe that if the Department finds it necessary to employ a protein specific threshold in the FMP definition, the industry may be encouraged to seek non-dairy protein for formulating products. The Department should not use the Fluid Milk Product definition to encourage the dairy industry to use non-dairy protein in the formulation of products. Alternative source costs of dairy protein are regularly reviewed internally at Dannon when formulating or reformulating products.

3.11.3 Conclusion: a protein threshold is confusing and can implement a wrong incentive for the dairy industry

Except for yogurt or yogurt-containing beverages, which should not be classified as Class I as we will demonstrate later, we encourage the Department to continue to use the 6.5% MSNF threshold as the standard for measuring the non-yogurt containing beverages' classification. That measurement is well known by the industry and should continue to serve as the standard.

4 The Dannon Company's proposal

4.1 Our proposed version of §1000.15 (b) (1) :

We propose that §1000.15 (b) (1) be amended to read:

> ***(1)Plain or sweetened evaporated milk/skim milk, sweetened/condensed milk/skim milk, formulas especially prepared for infant feeding or dietary use (meal replacement) that are packaged in hermetically sealed containers, yogurt containing beverages, any product that contains by weight less than 6.5 percent nonfat milk solids, and whey; and***
>
> * * * * *

Specifically, the paragraph above is an amendment to the current definition that would clarify that beverages containing yogurt are not considered to be "Fluid Milk Products". Such beverages may contain as much as 100% yogurt or as little as 20%. Under the California order, there is no minimum requirement for yogurt in the finished product.

4.2 Definition of yogurt containing beverages:

A yogurt containing beverage is any beverage that contains at least 20% yogurt.

4.3 Current classes of products at The Dannon Company:

Dannon is engaged in producing yogurt products that are classified and priced under the federal milk marketing orders as both Class I and Class II. All US manufacturing locations produce Class II products while Class I products are produced at the Ft. Worth, TX and West Jordan, UT locations.

The products we produce that currently are classified as Class I are Drinkable Danimals Lowfat Yogurt and Danactive Probiotic Cultured Dairy Drink. Other yogurt containing drinks we produce that are Class II are Smoothies under the Frusion, Light 'N Fit and Carb Control brand names. Dannon does not consider any of its products to be competitive with fluid milk; all of the products we produce comply with the standard of identity for yogurt, lowfat yogurt and nonfat yogurt as appropriate or are yogurts containing beverages that do not meet a standard of identity. Yogurt and yogurt-containing beverages do not compete with fluid milk for several reasons that we will point out.

4.4 Historical background:

4.4.1 Why is form and use of the essence?

The Agricultural Marketing Agreement Act of 1937 mandates that the Secretary classify milk "in accordance with the form in which or the purpose for which it is used". These broad guidelines offer little guidance to the Department with the

many new products that have appeared in the market in recent years. Over the years when the Department has opened any part of the classification system for consideration, the base operatives for classifying products have always been reduced to what is in the Act: "form or use". In the 60's, 70's, 90's and with the reform that occurred in 2000, the Department always relied on "form and use" for purposes of classification. We urge the Department to carefully remain focused on the statutory language and retain only the "form and use" argument.

4.4.2 The Nourse report:

In April 1962 the Federal Order Study Committee appointed by then Secretary Orville Freeman made their report to the Secretary. That report widely became known as the Nourse Report. Many of the guidelines presented in the report for the industry are equally as applicable in today's market as they were at that time. Mr. Nourse points out that classified pricing plans under the federal orders have as their primary objective increasing returns to producers and, secondarily, to assure that prices established for the lower classes are sufficiently low enough to allow milk that is surplus to fluid use in a market to clear. The committee's report notes that effectively administering a federal milk order program that is "in the public interest", as mandated by the Act, requires that the Secretary recognize the positions of dairy farmers, processors and consumers, each of which has its own set of demands and needs.

The Nourse Report also contained the following in its observations for Secretary Freeman:

> "Universally, the high priced category (Class I) includes milk used as fluid whole milk and generally includes closely related fluid products, such as skim milk and flavored milk. ... Observation indicates a close correlation between the types of products included in the high-priced categories and the existence of conditions that might lessen potential competition from alternative sources.
>
> The principle reason for including milk and its related fluid by-products in Class I is that because of sanitary requirements, transportation costs and other reasons, supplies tend to be limited to a relatively local milkshed. Further, the consumer demand for these products is such that relatively high prices can be charged without substantially reducing the quantities that will be absorbed by the market."

4.4.3 Conclusion:

With respect to Dannon's logistics and distribution patterns, we have three plants to serve the entire nation. A yogurt drink produced in Utah may be sold in Florida; while a Texas-produced drink product may be sold in California and Maine. Yogurt logistics are not limited to local consumption, as fluid milk tends to be, because we have extended shelf life over fluid milk. All of our products are distributed in all of the United States and the Virgin Islands.

The 1962 Committee had the same 1937 Act to guide it as the Department has today. We would like to call the Department's attention to "closely related fluid products" as contained in the excerpt. The Committee was clearly indicating that it believed that products that should be included in the Class I category should be very similar to fluid milk and that they should be competitive with fluid milk. Neither of these elements occurs with yogurt and yogurt containing beverages. The Committee traced the roots of classified pricing back to 1903, so the industry has been working on a solution to the issue for quite some time.

4.5 Class I, a simple answer to a complex problem:

Historically, the Department has classified fluid or beverage uses of milk in the highest priced classification: Class I. This is a simple solution for a complex issue. The issue becomes more complex with each innovative dairy drink product that is introduced in the marketplace. The classification tenet of "fluid or beverage form equals Class I" is invalid and should **not** be retained as a fundamental part of the classification process under the orders. Beverages containing some milk or milk derivatives do not necessarily, nor automatically, compete with sales of fluid milk. There are fundamental differences that distinguish yogurt beverages and yogurt-containing beverages from fluid milk.

4.5.1 Yogurt is less than 3% of the US milk production:

Each year when the Department publishes its Annual Summary for Federal Milk Order Market Statistics, Table 2 of that publication indicates certain dairy industry statistics for the various federal orders: number of markets, population within the markets, etc. One striking point in decline is the percentage of utilization of milk pooled on federal orders that goes into fluid milk for Class I purposes. That number has declined from 65% in 1947 to 41% at the end of 2003. During that same period the volume of producer milk pooled on the federal orders has moved from 15 billion pounds in 1947 to 111 billion pounds in 2003.

The National Agricultural Statistical Service (NASS) in its annual report for Dairy Products issued in April this year reported that there were 2.5 billion pounds of plain and fruit flavored yogurt produced by 98 plants in 2004. Dannon understands that the reported production data is for cup yogurt only. Drinkable yogurt data is not reported. Even if drinkable yogurts are placed at the same volume as cup yogurt, which would be high, the total yogurt use would be about 5 billion pounds for 2004. NASS's Milk Production report estimates that total US milk production in 2004 was 170.5 billion pounds. That would mean that the maximum total yogurt use of milk was around 2.9% of the milk produced with at most 1.45% going into yogurt drinks.

It is understandable that some parties have concerns over the decreasing percentage of producer milk on federal orders that ends up going into the

highest priced class of utilization. There is apparently less money to build the producer price differential. But, is that actually the case?

4.5.2 Class I, a limit to innovation:

The situation can exist, and does in our case and others, where pricing the products in the highest priced class can actually impair producer returns over the long run. No company will produce a product that will not yield a return in the marketplace. Placing all new products in Class I would be a strong signal to the industry to rethink product innovation. Product innovation is an avenue that the dairy industry must have to continue to develop products that appeal to consumers in terms of taste, texture, packaging and cost, regardless of the class of utilization. Stifling innovation would bring a sure, swift halt to research for products currently under development and both processors and producers will suffer as a result.

The yogurt market is driven by innovation. For instance, in 2004, over 37% of the volume sold in the US by Dannon came from products that were introduced in the last five years. Innovation is very important to us, as I am sure it is to every other processor.

We do not believe that is the objective of the Department and we encourage the Department to employ all avenues possible to keep product innovation thriving for the benefit of the industry so that dairy farmers and processors may continue to serve in harmony.

4.5.3 A quantitative model assessment from Cornell University:

Drs. Mark Stephenson and Charles Nicholson of Cornell University developed a model assessing market impact on the types of new products that prompted the original request for this hearing. Their analysis indicates that if the new products are all placed in Class I it will have such a small effect on the value in the total pool that producers really will not have a significantly improved base overall from which their Producer Price Differential is developed.

Dannon assumes that part of the rationale behind holding a hearing of this nature is to hear from the industry regarding proposals that will increase producer revenue and, thus, producer incomes.

The model developed by Cornell looked at several different scenarios.

- One in which the new product was initially classified as Class II then shifted to Class I.
- One in which the new product was introduced as Class II and stayed under that classification.

With regard to the quantity of milk, Cornell deliberately assumed a relatively, large quantity (equal to 5% of the US milk supply when sales of the new product reached their full growth potential) so that the potential positive effects of a

classification shift for producers could be assessed. Subsequent work from Cornell shows that the size of the market potential for the new product does not influence which class maximizes producer revenues.

According to the results of this study, an increase in demand for milk for the new product benefits producers regardless of the class to which the new products are assigned, and the bigger the increase in demand for the milk, the more the dairy producers will benefit. This is, however, a separate issue than what happens due changing classification for the new products. In previous work, Cornell tried to describe separately the effects of the increase in overall milk demand from the effects of shifting new products from Class I to Class II.

Cornell's model results indicate that there are some situations (assumptions, parameters) in which dairy producers would be better off even in the longer-term with the new product in Class I, and other situations where producers would be worse off. (The "base case" shows producers slightly worse off, but others show them slightly better off.) For the situations in which assigning new products to Class I increases producer revenues, the increase is always small (less than 0.1 percent). For the situations where producer revenues are decreased by moving new products from Class II to Class I, the decrease is also small unless there is substitution for non-dairy ingredients to make the new product. With that kind of substitution, there's the possibility of a large decrease in producer revenues if new product manufacturers have formulation options and are price sensitive.

Overall, under a very aggressive hypothesis regarding milk consumption for new products, there is more downside for the producers to have new products priced under Cass I because of the protein reformulation potential, because of increased supply triggered by Class I ultimately pushing all class prices down through an excess of milk production. Producers gains are similar between Class I and Class II scenarios, but losses may be big with a small likelihood under the Class I scenario, which in expectancy makes the producers better off under the Class II scenario than the Class I situation.

4.6 Yogurt and fluid milk have significant different price elasticities:

A base price elasticity of -1.1 means that a 10% increase in base price results in a 11% decrease in volume.

For Dannon according to a study carried out in 2004, price elasticities range from -0.64 for Frusion, -0.93 for LNF Smoothie to –1.17 for La Crème cup yogurt. The average is –0.96 for Dannon. Including other yogurts in the sample, the average elasticity is still –0.96 with a 95% confidence interval of [-1.38 ; -0.54].

The commonly adopted standard value for fluid milk based products is –0.20 which is not included in the 95% confidence interval for the elasticities of the Dannon products. In other words, yogurts and fluid milk based products have significantly different elasticities.

The elasticities of the Dannon Drinkable Yogurts are 2 to 3 times as high as fluid milk products. As a consequence, any move that would result in classifying more yogurt containing beverages into Class I, would result in a decrease of sales, meaning ultimately a decreased milk demand. A decreased milk demand from yogurt manufacturers has 2 negative impacts on producer revenues through low global demand and lower average pricing since the supply cannot adjust quickly to the demand.

4.7 The uniqueness of yogurt containing beverages:

Technically, the products that we produce are, regardless of their beverage form, yogurt or yogurt-containing foods made from cows' milk. These products or their principal ingredient meet a standard of identity as defined at 21CFR §131.200, §131.203 and §131.206, covering yogurt, lowfat yogurt and nonfat yogurt, respectively. In all three sections cited, yogurt is described as a food. The consuming public's perception is that yogurt is a food, regardless of the form in which it is purchased. All three CFR sections cited state that "yogurt is the food that is":

> *"... produced by culturing one or more of the optional ingredients specified (in the section) with a characterizing bacterial culture that contains the lactic acid-producing bacteria, Lactobacillus bulgaricus and Streptococcus thermophilus."*

4.7.1 Unique Cultures:

Both *Lactobacillus bulgaricus and Streptococcus thermophilus* cultures acidify the milk. The specific combination of strains provides the characteristics of the yogurt: tartness, acidity, texture, flavor... Within each product we carefully select individual strains of cultures that bring unique attributes. Each strain will behave differently depending upon the process of fermentation: how long and at what temperature is the fermentation to take place? All *Streptococcus thermophilus* cultures will not build the same texture. At Dannon, as it is throughout the Danone Group, we select our strains of culture and define our production processes with advanced technology to achieve the specific targets of taste, texture and claims we make for our products. With this knowledge we have the ability to produce a mild, thick and creamy yogurt like La Crème to be consumed as an indulgent product for dessert. Or, we can produce a more fluid product like Light 'n Fit Smoothies with a target consumer of someone on the go. The type of fruit, color and flavoring agents are also components that differentiate our products further from fluid milk.

4.7.2 Unique Technology:

The traditional manufacturing process used to produce yogurt is very different from the process used to produce bottled fluid milk. We heat treat the raw milk, skim the milk and move the skim milk to sterilized holding tanks. These initial steps are similar to those a bottling plant would take in packaging milk for fluid

use. However, the similarities cease at that point. From the holding tanks, our milk is mixed with other ingredients, then pumped to a vat where it is inoculated and fermented 6 to 8 hours. Following the fermentation process, the yogurt is cooled, sheared, stored in a vat and then is pumped to the filler lines. "Bulky flavors" (e.g. fruit puree, fruit juice, flavors) and, where appropriate, water, in the case of certain yogurt drinks, are added at this point. It is then packaged. The shearing process allows us to ensure the smoothness of the yogurt and to establish the right viscosity.

In each case, after the fermentation process, the white mass that results meets the standard of identity for the yogurt noted above. In a fresh dairy plant, milk is usually pasteurized and is cooled from there through the rest of the packaging process. Fresh dairy plants do not have to deal with heating, inoculation and fermentation processes in their operations. The yogurt process is significantly different from a fluid milk operation. A fluid milk processor will not be able to make yogurt without significant additional investment in equipment and lines for product flow.

4.7.3 Differences with buttermilk:

There is already a cultured product in the category of Class I: cultured buttermilk. Yogurt differs from that product as well. The cultures used to produce cultured buttermilk are the same type of cultures traditionally used to produce fresh cheese and other fermented dairy products. The cultured buttermilk product is fermented at 68°F for 12-15 hours.

To make yogurt, milk is fermented at over 100°F for 4 to 8 hours, depending on the process employed. The cultures used for buttermilk impart to the product a "cheese-like" flavor. Our cultures actually give the yogurt product a tart taste.

Cultured buttermilk is defined by FDA under the Cultured Milk standards found at 21CFR §101.112. One of the requirements for cultured buttermilk at that section is that the finished product must contain not less than 8.25% milk solids not fat (MSNF). In the case of yogurt we must meet that minimum "before the addition of bulky flavors".

California classified cultured buttermilk as Class II.

4.7.4 Conclusion: yogurt containing beverages are significantly different from Class I products

We may start with the same raw milk as a fluid processor does, but we use it to make a different product: yogurt. The Department has traditionally classified yogurt in the Class II category. We agree with and accept this classification.

We build a liquid texture through technology, culture strain selection and other ingredients selection, to make a product with specific characteristics that address consumer tastes and preferences. Through this use of technology and ingredient selection, we did not change the fact that the product meets the Standard of

Identity of Yogurt (or Lowfat or Nonfat, as appropriate), or that yogurt is the principal ingredient in the finished food. Whether water, fruit and other ingredients were added does not alter the classification of the product. If one takes a cup of our spoon-able yogurt, a Class II product, opens it and turns it on its side on a table, the yogurt will flow out of the cup. It will not run out as quickly as our beverage yogurt would, but it will eventually flow out of the cup. We cannot embrace the concept that we produce a Class I product from a Class II product through the addition of fruit puree, fruit juice, and in some cases water. We cannot accept the idea that any of our products compete with fluid milk.

Yogurt containing beverages result from a unique combination of technology, ingredients and cultures allowing the consumer to easily single out yogurts and yogurt containing beverages from any other Class I product, making competition between Class I product and yogurt containing beverages non-existent.

4.8 Form of yogurt containing beverages:

4.8.1 Packaging differences with other Class I products:

There is no disputing the fact that our yogurt containing beverages are in plastic bottles, just like fluid milk is usually found, though milk may also be purchased in glass bottles or gabled cartons. The size of our bottles ranges from 3.1 ounces to 10 ounces. Most fluid milk packages range from 8 ounces to a gallon. Usually fluid milk is purchased in containers that have multiple servings in the container. Most yogurt-containing beverages are purchased in single serve containers.

The packaging of the yogurt containing beverages has been designed to meet the lifestyle and the consumption habits of our consumers. Our on the go packaging influenced a lot the success of our products on the market place.

4.8.2 Taste and mouth feel differences with other Class I products:

The taste, mouth-feel and texture of our products are not like those of fluid milk. Our yogurt beverage products are significantly different from fluid milk by taste and texture. Some flavored milks are marketed that meet the fluid milk product definition but the texture will not be the same because they were not made from yogurt.

The thick, creamy texture of our beverages arises primarily because they are yogurt or contain as their principal ingredient the standardized food "yogurt". It isn't the same product as a glass of fluid milk and its use is not the same to the consumer. To the consumer, yogurt remains a healthy, nutritious food however it is purchased: in a bottle or in a cup.

4.8.3 On the shelf at the retail level :

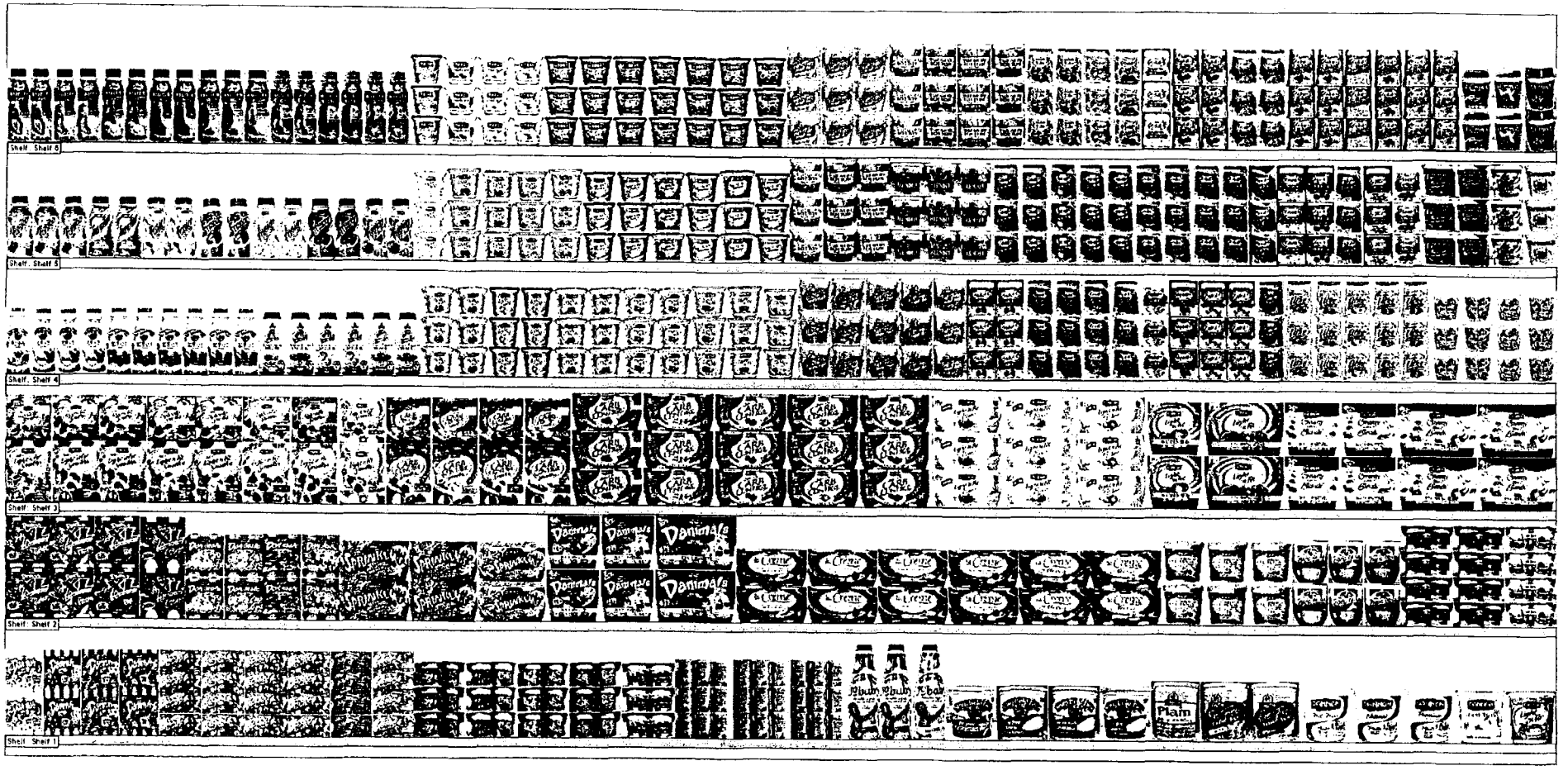
Fluid milk and yogurt containing beverages do not compete with each other. The products do not sit side by side in the same display case in the grocery store as

evidenced by the following "planogram" which shows that yogurt containing beverages are placed in the grocery store in the same section as "cup" yogurt.

In most grocery stores one will find a display case for fluid milk products and a separate case located elsewhere in the store for displaying yogurt products. The consumer has to make a conscientious effort and decision to buy each of the two products. The sale of one does not displace sales of the other. Each product is purchased for its own use.

2005 CORPORATE PLANOGRAM RECOMMENDATION

(source: The Dannon Company, Inc.)



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Yogurt containing beverages from many brands and spoonable yogurts are presented to the consumer on the same shelf competing within the same category. Fluid milk beverages or other Class I products do not belong to this category.

4.8.4 Shelf life differences with other Class I products:

Fluid milk and cultured buttermilk have both a shelf-life of about 21 days. The shelf-life for yogurt is at least 37 days and most of the time nearly three times longer than the shelf life for bottled milk.

Process and packaging differences allow yogurts and yogurt containing beverages to offer a significant shelf life difference to the consumer.

4.8.5 Conclusion: yogurt containing beverages' form is unique

Through their unique texture coming from fermentation, through their convenient on the go packaging and through their location within retail shops, yogurt containing beverages differentiate themselves clearly from Class I fluid milk products and do not compete against them.

4.9 Use of yogurt containing beverages:

4.9.1 Yogurt containing beverages yogurts and other fluid milk beverages are not substitutes:

Dannon's yogurts smoothies are purchased as a healthy, convenient, portable food snack for consumers on the go. Fluid milk is purchased for daily consumption as part of a snack or a meal.

Cannibalization occurs within each of the two product categories and not as a product from one category displacing a sale from the other. They are not substitutable products.

Even baking or cooking recipes will call for one or the other product, but it will not say "either/or". The uses of the products are not the same and warrant segregation in the same manner the federal orders use to discriminate the classes of utilization with pricing.

4.9.2 Market research for kids yogurt containing beverages:

In June and July 2003 Dannon commissioned an outside market research firm to conduct a study consisting of 678 interviews conducted in 12 geographically dispersed locations (Atlanta, Boston, Chicago, Detroit, Houston, Dallas, Jacksonville, New York, Los Angeles, Memphis, San Francisco, Trumbull). Respondents were females (18-59) who do at least half of the household shopping over the course of a year, and buy refrigerated yogurt (not necessarily children's) for a 3-11 year old in their household.

The consumers were also asked what food or beverage the Drinkable Danimals XL purchase would replace.

- 29% said it would replace food
- 6% said it would replace a beverage. Those 6% can be broken down as
  - 1% said the purchase of XL would replace the purchase of fluid milk

- 2% said the purchase of XL would replace the purchase of juice
- 2% did not know
Figures do not add up because of rounding errors.

- 64% said the purchase of XL would replace the purchase of another yogurt product.

In conclusion, less than 1% of the potential Danimals Drinkable XL consumers claim they would replace fluid milk by our yogurt containing beverages.

After 6 months on the shelf, we found that 95.5% of those buying the yogurt containing beverage Danimals XL were already yogurt buyers and switched consumption to Danimals XL. Another 3.4% increased their yogurt category consumption. 1.1% were new to the yogurt category.

Again per this other study, new comers to the category only represent 1.1%.

4.9.3 Market research for adult yogurt containing beverages:

A study conducted at Dannon's request, over 26 weeks ending August 24th 2003 examined the source of volume for Adults Shakes & Drinks segments and the Frusion Smoothie. Dannon Frusion consumers are coming from :

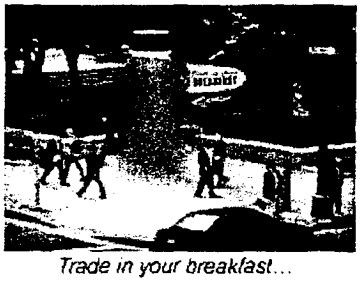
- 86% are brand switching within the yogurt category
- 9% are increasing consumption within the category
- new buyers to the category represented only 5%

Yogurt category is defined by the following segments : blended yogurts, traditional yogurts, plain yogurts, kids yogurt and light yogurts.

4.9.4 Advertisement positioning:

For kids and for adults, Dannon positions its yogurt containing beverages line as substitutes for snacks.

The Frusion storyboard below presents the Frusion yogurt based beverage as a healthy alternative to muffins, bagels, and donuts (below the muffin storyboard).

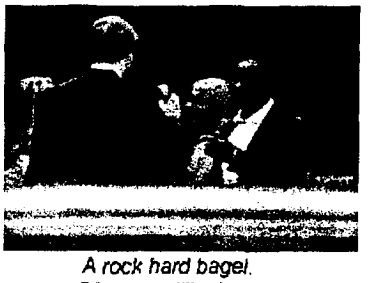


Trade in your breakfast...

Trade in your boring breakfast for a [Brand] smoothie.

One dry corn muffin...

...for the straight from the blender taste of a [Brand].

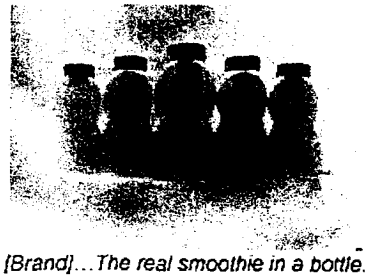


A rock hard bagel. Of course I'll take it.

Real fruit and yogurt, perfectly blended into the ultimate smoothie...

That's [Brand].

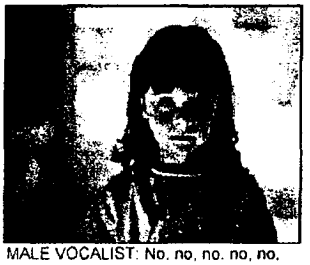
I'll take a dozen.



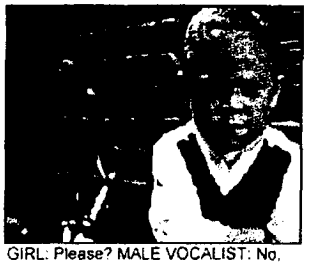
[Brand]...The real smoothie in a bottle.

The Danimals storyboard below presents the Danimals yogurt in its beverage and cup version as a healthy snack alternative for kids to cookies, gummi bears and potato chips (below the cookie storyboard).

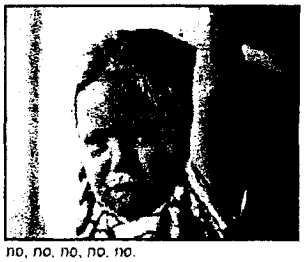
(MUSIC IN) GIRL (VO): Mom, can I?



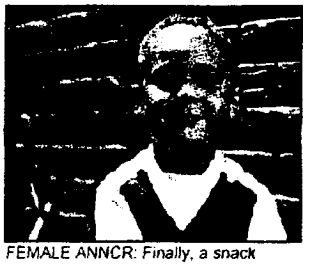
MALE VOCALIST: No, no, no, no, no, no, no, no.



GIRL: Please? MALE VOCALIST: No, no, no, no, no.

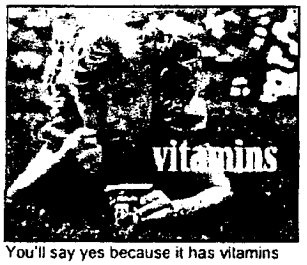


no, no, no, no, no.

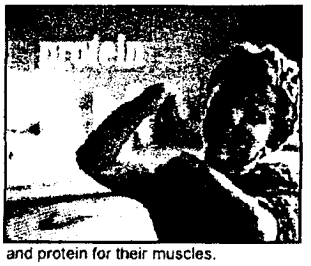


FEMALE ANNCR: *Finally, a snack*

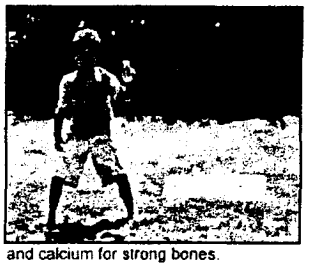
you can say yes to. Fun, fruitilicious Danimals Yogurt.



You'll say yes because it has vitamins

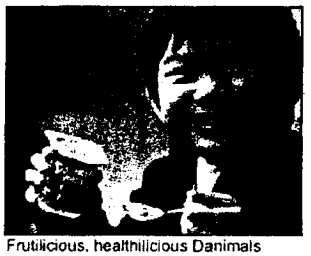


and protein for their muscles.

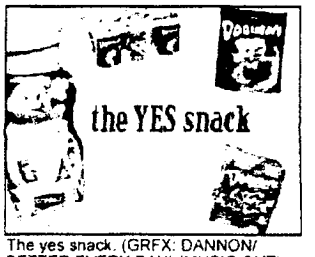


and calcium for strong bones.

They'll say yes because they love it.



Frutilicious, healthilicious Danimals Yogurt.



The yes snack. (GRFX: DANNON/ BETTER EVERY DAY) (MUSIC OUT)

Both commercials were aired either on TV or on radio within the last 12 months, in a national or regional set-up.

4.9.5 Conclusion: yogurt containing beverages' use is unique

Clearly our drinks are not competing with fluid milk. We are competitive within the yogurt category; not with fluid milk. Yogurt is a separate, identifiable dairy sub-category.

Yogurt-containing beverages are not competing with fluid milk sales and thus should not be linked with fluid milk sales. The consumers, adults and children, differentiate between yogurt products and fluid milk. The source of volume for the yogurt containing beverages comes overwhelmingly from within the yogurt category. Our studies show no evidence of significant cannibalization of fluid milk based products by yogurt containing beverages.

5 Conclusion

As we have demonstrated, yogurt containing beverage should be classified under Class II because:

- The cost of milk is the most important component of the raw materials we purchase.
- Yogurt beverages and yogurt containing beverages are truly different from fluid milk:
    - The taste, mouthfeel and texture derived through knowledge of technology and ingredient selection differs greatly between the two categories
    - The products are not packaged in the same way.
    - The products are not located side by side in the grocery store where about 70% of all yogurt sales occur. The consumer makes a conscious decision about buying each product type depending on consumer preferences in taste, texture, and usage occasion.
    - The actual manufacturing process is more technical and intensive with yogurt than with fluid milk, requiring, in the case of yogurt-containing products, extensive investments in research and development, innovative ingredients and processes, etc...
    - consumer purchases of yogurt-containing beverages are not made at the expense of fluid milk purchases.
    - The products are consumed for specific and different purposes
    - The products cannot be substituted for each other
    - Yogurt moves nationally, not locally or regionally as does fluid milk.
- Consumers, even children, know the two products are not the same and they treat them as different products when purchased. The beverage children drink most with yogurt is a glass of milk.
- Growth in the yogurt category is highly dependent upon product innovation.
- The yogurt category in total absorbs less than 3% of total milk produced in the US but is growing through product innovation. A change in classification will have an insignificant impact on dairy farmer incomes but will be a significant threat to product innovation.
- The Cornell economic model shows that dairy farmers and processors benefit the best when new products are classified as Class II.

- And, one last note, yogurt drinks are in the Class II category under the California milk order. California classified the products appropriately.

Some criticism has been directed at regulations that find their roots in the Act that was passed by Congress in 1937 and amended many times since. That Act, and amendments, has provided sufficient latitude for the Department to respond to consumer and industry fundamental and preferential changes over the years and continues to do so today. The federal order program has been widely called a "producer program", but we recognize the Department has always been cognizant of processors' needs as well. To us, the Department has tried to balance the producer, processor and consumer requirements equitably. It is in this light and background that Dannon respectfully requests that the Secretary grant our proposal to specifically eliminate all yogurts and yogurt-containing beverages from the definition of Fluid Milk Product under the federal milk marketing orders.

Thank you for this opportunity to appear and express the reasons for our request.